

MSP
#2**The IRS's Wage and Withholding Verification Procedures May Encroach on Taxpayer Rights and Delay Refund Processing****RESPONSIBLE OFFICIALS**

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DEFINITION OF PROBLEM

As the nation's tax collection agency, the IRS is responsible for processing over 141 million individual income tax returns annually, including nearly 120 million requests for refunds.¹ As part of this process, it must protect the public fisc from illegitimate refund requests while expeditiously processing legitimate tax returns and paying out legitimate refund claims. The dual tasks of fraud prevention and timely processing of returns present challenges even in the simplest of tax systems, and ours is far from simple. The recent increase in spending programs run through the tax code, combined with a reduction in IRS funding, has made the IRS's job much harder, and to better protect the public fisc from a surge of new refund schemes, the IRS has expanded its use of various automated screens to filter out questionable refund claims. The result is that more legitimate taxpayers are becoming ensnared in the IRS's revenue protection apparatus.

In fiscal year 2011, the Accounts Management Taxpayer Assurance Program (AMTAP) delayed nearly two million refund claims, identifying them as questionable or potentially fraudulent.² The Electronic Fraud Detection System (EFDS), which the IRS claims had an 89 percent accuracy rate in 2011, selected over one million returns for screening, a 72 percent increase from the previous year.³ In addition to these questionable refund claims selected by EFDS, AMTAP also identified 893,000 returns as part of the Operation Mass Mail (OMM) scheme in CY 2011 — and has no plans to process such OMM returns.⁴

¹ In fiscal year (FY) 2010, the IRS processed 141,617,000 individual tax returns. IRS 2010 Data Book, Table 2, *Number of Returns Filed by Type of Return, Fiscal Year 2010*. In FY 2010, the IRS processed 119,443,586 refund requests. IRS 2010 Data Book, Table 7, *Number of Refunds Issued by Type of Refund and State, Fiscal Year 2010*.

² The Electronic Fraud Detection System (EFDS) is one tool the IRS uses to select questionable returns for "verification" prior to releasing refunds. EFDS selected 1,054,704 questionable returns for screening in calendar year (CY) 2011. The IRS stopped an additional 893,267 potentially fraudulent returns as part of the Operation Mass Mail (OMM) program. See Wage and Investment (W&I) division response to TAS information request (July 27, 2011, and updated Nov. 4, 2011).

³ The volume of returns selected to be screened rose from 611,845 in CY 2010 to 1,054,704 in CY 2011 (through Oct. 15, 2011), a 72 percent increase. See W&I response to TAS information request (July 27, 2011, and updated Nov. 4, 2011). By the IRS's own estimation, it was unable to "verify bad" 11 percent of these returns, leaving up to 116,000 potentially "good" taxpayers improperly caught up in the EFDS filter. Of the approximately 20,600 pre-refund cases TAS closed in FY 2011, more than 16,000 taxpayers (79.8 percent) obtained relief. So by comparing these two numbers, it is reasonable to conclude that potentially 100,000 innocent taxpayers who did not come to TAS were harmed by the EFDS filter in 2011.

⁴ AMTAP identified 893,267 OMM returns through October 15, 2011. Email from AMTAP analyst (Nov. 4, 2011).

While the number of returns screened by EFDS rose by 72 percent, AMTAP staffing grew by less than nine percent,⁵ causing inventory to soar to 690,000 cases at one point during the 2011 filing season.⁶ As inventory levels increase, so do the delays in responding to legitimate refund claims. Although the manual process of verifying the taxpayer's wages and withholding is supposed to take 13 weeks or less, in practice the delay could be much longer.

In an effort to better understand the reasons for the significant increase in pre-refund cases, we conducted a study of a statistically representative sample of TAS's pre-refund wage verification cases closed in FY 2011 (hereinafter the "TAS study").⁷ In these cases, the average refund amount was over \$5,600 (median refund was approximately \$4,100), and the average delay was 25 weeks (median delay was slightly under 19 weeks). Requiring legitimate taxpayers to wait nearly half a year to receive refunds of this magnitude often imposes significant financial hardships. TAS found that the IRS had placed a hard freeze on the taxpayer's account in at least 50 percent of the cases in this sample, with taxpayers obtaining relief in 84 percent of the time.⁸

TAS often feels the effects of systemic problems within the IRS. In FY 2011, TAS received over 21,000 pre-refund cases, a 504 percent increase over cases received in FY 2010.⁹ Such cases constituted 7.2 percent of all TAS case receipts in FY 2011.¹⁰ Notably, we found that taxpayers coming to TAS with pre-refund problems ultimately received relief 75 percent of the time.

TAS typically issues one or more Operations Assistance Requests (OARs) to IRS functions to resolve open cases. In FY 2011, TAS issued nearly 25,000 OARs to AMTAP.¹¹ The unit did not complete the requested actions within three days of the negotiated timeframe on approximately 4,600 of those OARs – over 18 percent of the OARs issued to AMTAP.¹² To get AMTAP's attention, Local Taxpayer Advocates issued 210 Taxpayer Assistance Orders

⁵ The AMTAP staff increased from 336 in FY 2010 to 366 in FY 2011, a gain of nearly nine percent. See W&I response to TAS information request (July 27, 2011).

⁶ TAS notes from IRS Decedent Schemes conference call (Apr. 25, 2011).

⁷ TAS analyzed Compliance Data Warehouse (CDW) data from the Individual Returns Transaction File of 373 closed TAS cases with primary issue code (PIC) 045 (Pre-Refund Wage Verification) and PIC 425 (Stolen Identity) with secondary issue code (SIC) 045 cases pulled on October 11, 2011 (hereinafter "TAS Study"). The 373 cases are a representative sample of the FY 2011 TAS PIC 045 and PIC 425 SIC 045 cases. The sample has a margin of error of plus or minus 5.1 percent at a confidence level of 95 percent. The TAS study is not a representative sample of all IRS AMTAP cases.

⁸ See TAS Study. Hard freezes were almost certainly applied in additional cases. In some instances, the IRS may apply a hard freeze by inputting a second TC 570. Because the master file does not capture when a second TC 570 is input, TAS included in its count of hard freezes only cases that contained RCC 3 and TC 841 codes in the 373-case sample.

⁹ TAS, Business Performance Review (4th Quarter FY 2011). The 21,286 pre-refund wage verification (PIC 045) cases actually represent a 571 percent increase over the 3,171 PIC 045 cases received in FY 2010. However, because TAS did not use PIC 045 until March 24, 2010, a more appropriate comparison would be between PIC 045 case receipts from the last two quarters of FY 2011 (18,018 cases) and the last two quarters of FY 2010 (2,981 cases), which represents a 504 percent increase. See TAS, Business Performance Review (4th Quarter FY 2010 and 4th Quarter FY 2011).

¹⁰ TAS received 295,904 cases in FY 2011. See TAS Business Performance Review (4th Quarter FY 2011).

¹¹ TAS issued 24,911 OARs to TAMIS in FY 2011. Data obtained from Taxpayer Advocate Management System (TAMIS) (Nov. 2, 2011).

¹² AMTAP did not complete the requested action within three days of the negotiated timeframe in 4,606 OARS in FY 2011. Data obtained from TAMIS (Nov. 2, 2011).

(TAOs) to AMTAP in FY 2011, approximately equal to the number issued to all other IRS functions combined, and more than TAS has issued to the IRS in any preceding year.¹³ Given that Local Taxpayer Advocates had such difficulty getting AMTAP to respond to their requests for help and directions for action, it seems likely that taxpayers who proceeded without TAS assistance faced even greater resistance.

The prevalent use of refund freezes is reminiscent of the IRS Criminal Investigation (CI) division’s prior practice of freezing refund claims through its Questionable Refund Program (QRP). In her 2005 Annual Report to Congress, the National Taxpayer Advocate criticized the QRP for, among other problems, freezing the legitimate refunds of tens of thousands of taxpayers without notifying them or giving them an opportunity to respond.¹⁴ In response to the National Taxpayer Advocate’s concerns, the IRS moved the refund verification process from CI to the Wage and Investment (W&I) division in 2009. Although the IRS has expanded its notification process to alert most taxpayers whose returns face verification, many of our concerns remain, including:

- The IRS should limit its use of hard refund freezes to cases that exhibit clear indicia of fraud. Hard freezes should never be used simply as an inventory management tool.
- AMTAP selects more returns than ever but relies on screens based on imperfect data, increasing the risk of taxpayer harm.
- The IRS does not notify taxpayers when it “auto-voids” certain suspicious refund claims.
- The IRS does not have sufficient staffing and systems resources to keep up with its mounting AMTAP inventory.¹⁵
- The IRS should be careful not to abridge taxpayer rights as it proposes new initiatives to address questionable refunds.

ANALYSIS OF PROBLEM

Background

At the time that the National Taxpayer Advocate identified refund freezes as a most serious problem in her 2005 Annual Report to Congress, the IRS Criminal Investigation function

¹³ Internal Revenue Code (IRC) § 7811 authorizes the National Taxpayer Advocate to issue a Taxpayer Assistance Order when a taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered if relief is not granted. See IRC § 7811(a) (1); IRM 13.1.20.1 (Dec. 15, 2007). TAS issued a total of 422 TAOs in FY 2011. In FY 2010, TAS issued a total of 95 TAOs. TAS, Business Performance Review (4th quarter FY 2011).

¹⁴ See National Taxpayer Advocate 2005 Annual Report to Congress 25 (Most Serious Problem: *Criminal Investigation Refund Freezes*); National Taxpayer Advocate 2005 Annual Report to Congress vol. 2 (*Criminal Investigation Refund Freeze Study*). See also National Taxpayer Advocate 2006 Annual Report to Congress 408 (Status Update: *Major Improvements in the Questionable Refund Program and Some Continuing Concerns*).

¹⁵ EFDS is operating at maximum capacity, meaning the system cannot accept any more new users or data without first deleting current users or data.

(CI) was operating the QRP.¹⁶ Following a 400 percent increase in TAS cases originating from CI, TAS conducted a research study that found that taxpayers in over 80 percent of the decided cases in the statistically representative case sample received at least a partial refund (66 percent had received a full refund) and that taxpayers had to wait about nine months, on average, to receive these refunds.¹⁷ As part of the study, TAS learned that well over 200,000 taxpayers with frozen refunds never received any notice of CI's actions, and CI had taken no action to resolve those disputed refund claims.¹⁸

Following the National Taxpayer Advocate's 2005 report and consequent congressional and public criticism, the IRS agreed to dramatically alter the QRP procedures, including transitioning them out of CI and into W&I.¹⁹ The Commissioner established an Executive Steering Committee consisting of representatives from CI, TAS, the Examination functions of W&I and the Small Business/Self-Employment Division (SB/SE), the Accounts Management function in W&I, and Modernization & Information Technology Services. After weeks of negotiations, a memorandum of understanding (MOU) regarding revised QRP procedures was agreed to by the National Taxpayer Advocate; Chief, CI; Commissioner, W&I; and Commissioner, SB/SE.²⁰ The 2006 MOU set forth the following process:

1. The IRS can delay processing of refund claims for up to 14 days in order to identify questionable claims. CI will then have to either post the return and release the refund or temporarily freeze the refund claim for further investigation.
2. If it chooses the temporary freeze, CI will have up to 70 days (*i.e.*, ten weeks or "processing cycles") from the date the return is posted either to release the refund or to impose a hard freeze on the claim.
3. If CI imposes a hard freeze, its employees must decide within a reasonable time whether to investigate the case as part of a fraudulent scheme, refer the case to the IRS Compliance function for further investigation, disallow the claim, or release the refund.

In October 2009, W&I fully assumed responsibility over the QRP, under the Accounts Management Taxpayer Assurance Program (AMTAP). In October 2011, the group moved

¹⁶ The National Taxpayer Advocate made the following recommendations in her 2005 Annual Report to Congress: (1) the IRS should notify all taxpayers within two weeks whenever it places a freeze on a refund claim; (2) once CI "determines" that fraud exists, it should immediately refer the case to the Examination function or it should immediately notify the taxpayer of his or her right to file a refund suit in court; (3) the IRS should give serious consideration to moving the initial screening outside the CI function; (4) the IRS should devote additional resources to improving the accuracy of its screening methods; (5) the IRS should review CI's policy of freezing refunds for a certain number of years after it "determines" fraud on a taxpayer's return; (6) CI should facilitate a study of a random sample of frozen-refund cases in which the affected taxpayers have not contacted TAS; and (7) when releasing reports of revenue protected by the QRP, the IRS should be more complete in describing the achievements and limitations of the QRP. See National Taxpayer Advocate 2005 Annual Report to Congress 52-54.

¹⁷ National Taxpayer Advocate 2005 Annual Report to Congress vol. 2, 2.

¹⁸ National Taxpayer Advocate 2006 Annual Report to Congress 411.

¹⁹ See New York Times, *Editorial: Guilty Until Proven Innocent* (Jan. 20, 2006); Tax Notes, *Players In IRS Restructuring Effort Distressed By Frozen Refunds*, 2006 TNT 9-1 (Jan. 12, 2006); Tax Notes, *Editorial: The Refund Freeze Program Warrants Outrage* (Jan. 18, 2006); Tax Notes, *Senate Democrats Ask Snow to Examine IRS Questionable Refund Program* (Jan. 23, 2006); Tax Notes Today, *Capitol Hill Hot Over Frozen Refunds*, 2006 TNT 13-1 (Jan. 19, 2006).

²⁰ See Memorandum Regarding IRS Criminal Investigation Questionable Refund Program Procedures (Feb. 3, 2006).

from Accounts Management to a newly created W&I organization called Return Integrity & Correspondence Services.

AMTAP’s main objective as a pre-refund revenue protection program is to identify and stop fraudulent refunds primarily generated as a consequence of misreported wages and withholding. The Electronic Fraud Detection System, built in the 1990s, filters all refund returns pursuant to business rules designed to distinguish good returns from bad ones, and it flags returns with a high perceived risk of fraud.²¹

When EFDS selects a return for screening, the return is “re-sequenced” (*i.e.*, the posting of return information is delayed) for up to 14 days. If the return screening suggests the likelihood of fraud, AMTAP places a temporary refund freeze on the account for 11 weeks to allow time for wage and withholding verification. AMTAP sends a letter informing the taxpayer that income, withholding, or tax credits are being “reviewed” and that the refund is being held for a more thorough assessment.²²

One method AMTAP uses to verify return information during this review period is to compare it with the Information Returns Master File (IRMF).²³ However, IRMF information for the prior year is not available until mid-May (one month after the regular April 15 filing deadline).²⁴ If the IRMF were available in real time, or even a month earlier, it would alleviate a great deal of burden for the thousands of taxpayers whose refunds are held up for wage withholding “verification.”²⁵ Notably, the IRS does obtain wage and withholding data from certain large employers in real time, which enables the IRS to conduct some real time matching.

If AMTAP cannot initially verify wage and withholding documents through systemic filters, it moves on to a manual “verification” process. AMTAP employees attempt to contact the employer to verify the amounts reported on the return via disc, fax, or phone.²⁶ If AMTAP verifies the wages and withholding as accurate, the IRS will release the refund.

²¹ Based on prior years’ returns, including those involving “verified” fraud, models are built and implemented for detecting fraud. Incoming returns requesting refunds are passed through the knowledge base and scored for likelihood of fraud. Returns that are flagged are diverted into a workload for further inspection before any refund is issued. Kenneth A. Kaufman, *An Analysis of Data Mining in the Electronic Fraud Detection System* (Apr. 28, 2010).

²² Notice CP 05, *Information Regarding Your Refund*.

²³ The IMRF contains third party information including wage and withholding reported on Forms W-2 *Wage and Tax Statement*, and most Forms 1099, *U.S. Information Return*. Under present law, issuers who file these forms electronically have until March 31 to file them with the government. Issuers send Forms 1099 directly to the IRS and Forms W-2 directly to the Social Security Administration (SSA), which in turn sends information extracted from the forms to the IRS each week, starting in late March. IRC §§ 6051(a), 6049(a), 6042(a); see *IRS Instructions for Forms W-2 and W-3, Wage and Tax Statement and Transmittal of Wage and Tax Statements*; Social Security Administration, *Employer W-2 Filing Instructions & Information*, available at <http://www.ssa.gov/employer/gen.htm> (last visited Oct. 31, 2011).

²⁴ Per IRM 2.3.35.1.1 (May 3, 2010), TY 2011 data should be accessible online by May 11, 2012.

²⁵ See Most Serious Problem: *Reinstatement of a Modernized Telefile Would Reduce Taxpayer Burden and Benefit Tax Administration*, *infra*. However, we understand that the AMTAP currently does not have an automated way to utilize IRPTR information, so this matching must be conducted manually, further delaying the “verification” process.

²⁶ IRM 21.9.1.8(2) (Oct. 1, 2010).

If AMTAP cannot verify the information through internal records or by contacting the employer, the IRS sends the taxpayer a Letter 4115C with an “unable to verify” paragraph requesting documentation (e.g., pay stubs, Forms W-2), and extends the refund hold.²⁷ AMTAP will also extend the hold when information has not been verified and the temporary hold is expiring.²⁸

The IRS Should Use Hard Refund Freezes Only When There Is an Indication of Fraud, Not as an Inventory Management Tool.

Given the importance of protecting taxpayers and the tax system from refund fraud and improper payments, the National Taxpayer Advocate believes that the IRS should have a reasonable amount of time in which to determine whether the refund claim bears the “badges of fraud” or is otherwise suspect, such that it should be held for further investigation or examination. As provided in the 2006 memorandum, the IRS and the National Taxpayer Advocate agreed that releasing refunds systemically within 70 calendar days of the initial refund freeze (then known as a “P-freeze”), unless it referred the case for criminal investigation (such cases received a “Z-freeze”), struck an appropriate balance between revenue protection and taxpayer burden.²⁹ As a consequence, CI issued guidance stating that a P-freeze “must be resolved within 70 calendar days; if not, the refund will be automatically released through master file programming.”³⁰

With the Questionable Refund Program transferred from CI to W&I, the National Taxpayer Advocate is concerned that the IRS is moving away from its commitment to release refunds if it cannot determine in a reasonable time that a claim requires additional investigation. Current procedures advise IRS employees that “[i]t may be necessary to take additional actions to hold the refund after the 11 cycle freeze [77 days on top of the two-week re-sequencing] if a permanent freeze has not posted and the final return disposition still is uncertain.”³¹

The IRS does not systemically release refunds within 70 days, harming taxpayers and violating the 2006 Memorandum of Understanding with the National Taxpayer Advocate.

The current process of manually matching wage and withholding information is labor-intensive and further delays legitimate refund requests. While verifying wages and withholding is necessary to protect against improper claims, such delays can create real financial

²⁷ IRM 21.9.1.8.4(6) (Mar. 31, 2011); IRM 21.9.1.11.6 (Mar. 7, 2011). Letter 4115 requests income documentation from the taxpayer/employee (e.g., copies of checks, bank statements, pay statements, check stubs, and employer letters).

²⁸ Email from AMTAP analyst (Sept. 28, 2011).

²⁹ See Memorandum Regarding IRS Criminal Investigation Questionable Refund Program Procedures (Feb. 3, 2006); National Taxpayer Advocate 2006 Annual Report to Congress 412; IRS, *Fraud Detection Center - FDC Guidelines for Processing Year 2007 Issued by Refund Crimes and the Fraud Detection Centers* 17 (Dec. 2006).

³⁰ See IRS, *Fraud Detection Center - FDC Guidelines for Processing Year 2007 Issued by Refund Crimes and the Fraud Detection Centers* 17 (Dec. 2006).

³¹ IRM 21.9.1.2.3(1), *Stopping the Refund* (Oct. 1, 2010). IRM 21.9.1.2.5 does instruct AMTAP employees to send the 4115 letter requesting additional information, but does not specify that this letter should be sent when the hard freeze is input on the account.

hardship for taxpayers awaiting legitimate refunds. Despite the significant challenges the IRS is facing, we believe that requiring honest taxpayers to wait more than ten weeks to receive their refunds — and often substantially more than ten weeks — imposes a heavy burden. Moreover, ten weeks should be enough time for the IRS to determine whether a refund claim is so questionable as to require a “hard freeze” or a referral to Examination personnel.

In practice, the IRS routinely extends refund freezes past 11 weeks by placing hard freezes on accounts. *The IRS has informed TAS that it applied a subsequent freeze to 414,000 taxpayer accounts in FY 2011.*³² We are concerned that, instead of releasing refunds after 11 weeks when it cannot determine they warrant deeper scrutiny, AMTAP is placing hard freezes on the accounts simply because it could not verify wages and withholding within the established timeframe. In other words, AMTAP is using a hard freeze — normally designated for accounts in which potentially fraudulent activity has been “verified” — as an inventory management tool, without first having conducted sufficient analysis of relative risk.

*A TAS review of a representative sample of TAS pre-refund cases closed in FY 2011 shows that the taxpayers who received a hard refund freeze obtained relief 84 percent of the time.*³³

In a review of TAS pre-refund cases closed in FY 2011, we found that the IRS had applied a “hard freeze” in at least 50 percent of cases reviewed.³⁴ In such cases, taxpayers obtained relief 84 percent of the time — with full relief in 81 percent of these cases.³⁵ The review confirmed that even in cases where the IRS applied a hard freeze to an account, the IRS ultimately agreed that approximately five out of every six taxpayers who received a hard refund freeze and came to TAS were eligible for relief (with four out of five taxpayers receiving full relief).³⁶ While the TAS study is not a representative sample of all AMTAP cases, it demonstrates that the IRS screens suffer from significant flaws that impose heavy burdens on legitimate taxpayers.

When a case has a temporary, expiring freeze code, IRS employees have an incentive to work the case within the agreed-upon timeframe. If a permanent, hard freeze replaces the soft freeze, this incentive no longer exists. With competing priorities, the temptation is to work current cases and let cases with a hard freeze languish. This is the same situation that prompted the National Taxpayer Advocate to highlight the problems in CI procedures in 2005 and 2006. Today, these problems still exist, except that they involve IRS employees on the civil side, rather than from CI.

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Email from AMTAP analyst (Oct. 4, 2011). AMTAP cannot determine how many of these related to known schemes or cases where it was unable to verify wages or withholding.

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See TAS Study.

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See *id.*

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Id.

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Id.

The IRS should not address its resource shortfall by using permanent refund freezes as an inventory management tool. Refunds should be held past the agreed-upon 11-week period only in limited circumstances (*e.g.*, where AMTAP has reason to believe the taxpayer was involved in a scheme based on a referral from CI or other law enforcement agencies). Absent exigent circumstances, the IRS should adhere to its commitment to systemically release frozen refunds if cannot determine within 70 days that the return is part of a scheme or merits more investigation. If this is not possible with the present staffing levels in AMTAP, then fairness and due process considerations require the IRS to increase the program’s staffing, as well as to continually improve its filtering criteria.³⁷

AMTAP Selects More Returns than Ever, but Relies on Screens Based on Imperfect Data, Increasing the Risk of Taxpayer Harm.

The IRS appears to be facing a growing influx of sophisticated criminal schemes designed to claim improper refunds. In response, the IRS is increasingly using external databases to identify and prevent refund fraud. For example, the IRS has identified a fraudulent refund scheme involving prisoner Social Security numbers (SSNs). The Earned Income Tax Credit (EITC) excludes from the definition of earned income any amount received for services provided by an inmate.³⁸ Despite this limitation, the IRS continues to receive refund claims originating from prisons, such as false EITC claims or overstated withholding.³⁹ To combat prisoner EITC schemes, the IRS uses state prison system records to systemically deny refund claims from inmates who have been incarcerated for the entire year.

The National Taxpayer Advocate is concerned that the IRS is relying on inaccurate state information to systemically deny such refund claims. The Treasury Inspector General for Tax Administration (TIGTA) noted in a December 2010 report that 12 percent of the data in the 2009 prisoner file contained inaccurate or missing information.⁴⁰ For example, the prisoner file may contain inaccurate SSNs, dates of birth, and release dates. If a release date is incorrect, the IRS may deny a refund to an ex-prisoner who is entitled to the refund because it accrued before incarceration or after release from prison. One possible result of

³⁷ The National Taxpayer Advocate recognizes that in the current budget environment, the IRS must make a choice between increasing AMTAP staffing and using its resources elsewhere in the agency. Ultimately, we encourage Congress to fund IRS adequately to both protect revenue and assist legitimate taxpayers in receiving their refunds timely. See Most Serious Problem: *The IRS Is Not Adequately Funded to Serve Taxpayers and Collect Taxes*, *supra*.

³⁸ IRC § 32(c)(2)(B)(iv). This includes amounts received for work performed while in a work release program or while in a halfway house.

³⁹ Not all prison schemes involve prisoners committing the fraudulent act. In some instances, the fraudulent schemes originate from prison employees who unlawfully obtain the names and SSNs of inmates to file falsified refund claims. See Department of Justice, *Plea Entered in Prison Tax Refund Ring* (June 14, 2007), available at www.justice.gov/tax/usaopress/2007/txdv0720070614_Robinson_TpaTaxPlea.pdf.

⁴⁰ See TIGTA, Ref. No. 2011-40-009, *Significant Problems Still Exist with Internal Revenue Service Efforts to Identify Prisoner Tax Refund Fraud* 10 (Dec. 29, 2010).

the IRS's dependence on unreliable data as the basis of an adjustment is that the IRS may lose its presumption of correctness if a taxpayer challenges the assessment in court.⁴¹

In discussions with TAS, the IRS has recognized the need to validate the accuracy of such information obtained from third parties, but it has not articulated or committed to precisely how and when it will do the validation. If validation is not done before the 2012 filing season, the IRS will create unnecessary work for its already over-burdened program and inflict unnecessary harm on taxpayers.

The IRS has identified another scheme that has been dubbed "Operation Mass Mail." Tax returns identified as being part of this scheme are simply not processed (*i.e.*, they are "auto-voided," in IRS parlance). In CY 2011, AMTAP identified approximately 893,000 returns that fit OMM criteria.⁴² When an impacted taxpayer calls the IRS to inquire about his or her refund, the customer service representative will instruct the taxpayer to re-submit the return, but will not advise the taxpayer of its "auto-void" status — which means that the tax return is put aside and not processed, and the taxpayer is never notified.⁴³ Thus, rather than engaging with the taxpayer and giving him or her an opportunity to correct or explain the questionable item, the IRS creates more work for itself by telling the taxpayer to re-submit the return. Moreover, because the IRS does not use the opportunity to obtain more information from the taxpayer, the re-submitted return may again be "auto-voided."

The IRS has no systemic filters that kick out OMM returns, relying instead on its employees' discretion in flagging these returns as being suspicious based upon a manual review. The rules used to identify an OMM return are sweeping in their reach and have the potential to ensnare many legitimate taxpayers.⁴⁴ The OMM program in CY 2011 potentially impacted over 34,000 innocent taxpayers (almost eight percent of the returns originally marked "OMM") who had no idea that their returns had been "auto-voided."⁴⁵ Some of these taxpayers came to TAS for help in obtaining their legitimate refunds. In the TAS study, 23 out of 373 cases (six percent) were identified as OMM cases.⁴⁶ Of these, TAS was able to obtain relief in 17 cases, or 74 percent of the time (with full relief in 16 cases,

⁴¹ IRC § 6201(d) may require the IRS to prove that its determination is based on "reasonable and probative information" in any court proceeding regarding a deficiency based on an information return. IRC § 6201(d) was enacted following the IRS's loss in *Portillo v. Comm'r*, 932 F.2d 1128 (5th Cir. 1991) (described at IRM 4.10.4.6.1.3.2(2)), where it relied on information from a third party (Form 1099 from a customer of the taxpayer) to assert that the taxpayer underreported income. Although the IRS established that the taxpayer was a painter who engaged in painting during the period in question, the court held the IRS's statutory notice of deficiency was "arbitrary and erroneous" and not entitled to a "presumption of correctness" because the IRS failed to establish that the taxpayer received the unreported income shown on a Form 1099 after the taxpayer cooperated and raised reasonable concerns about its accuracy. For a more detailed discussion, see the introduction to the revenue protection MSPs, *supra*.

⁴² AMTAP identified 893,267 OMM returns through October 15, 2011. Email AMTAP analyst (Nov. 4, 2011).

⁴³ See IRM 21.4.1.3.1.1 (Aug. 12, 2011).

⁴⁴ The National Taxpayer Advocate is not at liberty to disclose these OMM criteria, but has expressed her concern to the highest levels of the IRS about the sweep of these rules and their underlying assumptions.

⁴⁵ In CY 2011 (through September 30), AMTAP marked 429,108 taxpayer accounts with OMM. During this period, AMTAP marked 34,053 accounts with OMM GB, nearly eight percent of the total. An OMM GB marker means that after the IRS initially nullified a return as OMM, it later determined the return was from a legitimate taxpayer reporting the correct wages and withholding, and should have been processed. Privacy, Information Protection and Data Security (PIPDS) Incident Tracking Statistics Report (Sept. 30, 2011).

⁴⁶ See TAS Study.

70 percent of the time).⁴⁷ We are concerned that the broad and vague scope of the rules, coupled with inadequate training of employees, causes legitimate returns to be branded as OMM returns, with severe consequences to the taxpayers.

The IRS Does Not Notify Taxpayers When It “Auto-Voids” Certain Suspicious Refund Claims.

Under the OMM “auto-void” procedures, the impacted taxpayer is given no notice and no opportunity to respond. This lack of communication was one of the main concerns raised in the National Taxpayer Advocate’s 2005 Annual Report to Congress, when CI was in charge of the QRP:

Because of the seriousness of fraud, the government generally affords taxpayers an extra measure of protection before making determinations. Indeed, the general rule that the taxpayer bears the burden of proof in tax liability disputes is reversed where the IRS asserts fraud; the government bears the burden of proving fraud in court. Yet despite the serious consequences of a finding of fraud, the IRS often freezes refunds without advising the taxpayer that it has made a determination of fraud, of the reasons for the determination, or of the consequences of that determination. Unless the taxpayer takes the affirmative step of contacting the IRS to inquire about his or her refund, the taxpayer may never know the IRS’s position with respect to that return.⁴⁸

Six years later, the QRP has been passed on to W&I, but the concern regarding lack of taxpayer notification remains.

As the nation’s tax administrator, the IRS has an obligation to process all tax returns that meet the requirements of a timely filed return. However, under the OMM procedures, the IRS simply refuses to process a large subset of returns on the theory that a fraudulent return is a “nullity.” While non-processing of a “nullity” may be proper in limited circumstances where the IRS has actual evidence that an identity thief has filed a fictitious return, we do not believe that the IRS has the legal authority to determine that a tax return is a “nullity” based on a cursory screening, particularly in the OMM situation, where the screening rules are so broad and vague and where the IRS acknowledges it errs in tens of thousands of cases.

The IRS Does Not Have Sufficient Staffing or Systems Resources to Keep Up with Mounting AMTAP Inventory.

While the number of returns selected for screening increased by 72 percent in 2011, AMTAP has not increased staffing accordingly.⁴⁹ AMTAP staffing in June 2011 was only

⁴⁷ See TAS Study.

⁴⁸ National Taxpayer Advocate 2005 Annual Report to Congress 27.

⁴⁹ The volume of returns selected to be screened rose from 611,845 in CY 2010 to 1,054,704 in CY 2011, a 72 percent increase. See W&I response to TAS information request (July 27, 2011, and updated Nov. 4, 2011).

about nine percent higher than in June 2010.⁵⁰ This disparity between workload and re-sources caused AMTAP’s inventory level to rise to 690,000 cases at one point in FY 2011.⁵¹ The hundreds of thousands of taxpayers caught up in the backlog may have to wait months for their refunds. This delay creates downstream work (such as the filing of duplicate returns and processing of additional correspondence) and forces the IRS to respond to a significant volume of additional calls from taxpayers inquiring about refunds.

With a significantly increasing volume of questionable refund claims coming in, EFDS is reviewing more returns than ever. EFDS, originally built in the 1990s, is nearing its maxi-mum capacity. The IRS plans to replace EFDS with the Return Review Program (RRP) to alleviate this capacity concern. RRP is an integrated and unified system that will enhance the IRS’s capabilities to prevent, detect, and resolve criminal and civil tax non-compliance. The IRS will begin phasing in RRP in 2013, but it may not be fully operational until 2014 or beyond.

The IRS Should Be Careful Not to Abridge Taxpayer Rights as It Proposes New Initiatives to Address Questionable Refunds.

In FY 2011, IRS convened a team called the Accelerated Revenue Assurance Program (ARAP) to develop front-end verification procedures to prevent the payment of improper refund claims. For example, one of ARAP’s proposals is for AMTAP to obtain access to the IRMF information earlier in the filing season, which may allow it to more easily “verify” a significant portion of its inventory.

The National Taxpayer Advocate is concerned that some ARAP proposals may infringe upon taxpayer rights. For example, ARAP has considered expanded use of the IRS’s math error authority. Math error authority can be an effective processing tool in limited circumstances,⁵² but it is only appropriate when errors are apparent on the face of a return or from information provided on a return. ARAP proposes that the IRS expand its use of math error authority to more complicated and facts-and-circumstances-based provisions. TAS has identified several proposals (*e.g.*, involving the adoption credit, education credits, and residential energy credit) whereby legitimately qualifying taxpayers could erroneously be issued a math error notice.

ARAP has also discussed using an automated process (called Automated Questionable Credits, or AQC) to deny certain below-tolerance refund claims. TAS raised several concerns about the AQC process. First, we noted the disparate treatment of low income taxpayers, who could be subject to multiple reviews or examinations of the same tax return,

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AMTAP staff increased from 336 in FY 2010 to 366 in FY 2011, an increase of 8.9 percent. See W&I response to TAS information request (July 27, 2011).

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IRS Decedent Schemes Conference Call (Apr. 21, 2011). AMTAP inventory not only includes cases requiring manual verification, but also decedent scheme identity theft cases and OMM cases.

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See Most Serious Problem: *Expansion of Math Error Authority and Lack of Notice Clarity Create Unnecessary Burden and Jeopardize Taxpayer Rights*, *infra*. The early legislative history of math error clearly shows that the deviation from deficiency procedures was to be limited in scope. See Legislative Recommendation: *Mandate that the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error Authority to Protect Taxpayer Rights*, *infra*.

while higher-income taxpayers and businesses would not. We also expressed concerns about the ambiguous language in the letter to taxpayers subject to the AQC process. Over the National Taxpayer Advocate's objections, for example, the letter to taxpayers in the AQC pilot did not include the word "audit" or "examination" even though there are dire consequences for not responding to this ambiguous letter and we believe the vague wording obscures those consequences.

As the IRS is exploring the use of systemic tools and processes to reduce AMTAP's workload, it is important that the IRS thoroughly analyze the legal and policy ramifications of each proposal. The IRS should first determine the specific legal basis for the changes, determine what notices are required by law (*e.g.*, Notice of Claim Disallowance or Statutory Notice of Deficiency), and examine whether taxpayers have an adequate opportunity to challenge the IRS's determination. The IRS should not let bad facts (*e.g.*, the influx of new schemes) dictate bad policy (*e.g.*, ignoring the requirements for taxpayer notice or simply refusing to process tax returns it suspects of being fraudulent).

Taxpayers Coming to TAS with Pre-Refund Wage Verification Problems Obtained Relief at Least 75 Percent of the Time.

Despite the significant increase in cases selected for review, EFDS purports to have a fairly high reliability rate. The IRS asserts that approximately 89 percent of the returns selected in 2011 (through October 15) as questionable have been "verified bad" — an upward trend from 68 percent "verified bad" in 2009 and 85 percent in 2010.⁵³ The National Taxpayer Advocate questions what the IRS means by "verified bad," because a TAS review of its AMTAP-related cases showed surprising results.

In the TAS study, 75 percent of the taxpayers who came to TAS with AMTAP-related issues obtained relief. This finding was corroborated when we analyzed data from every closed TAS case in FY 2011 with a Primary Issue Code 045 (Pre-Refund Wage Verification) or PIC 425 (Stolen Identity) with a Secondary Issue Code 045 — over 20,000 cases.⁵⁴ According to this analysis, taxpayers obtained relief from the IRS in 79.8 percent of these cases, with taxpayers receiving full relief 72.3 percent of the time.

Note that when taxpayers come to TAS for assistance, TAS generally must obtain the concurrence of the IRS function "owning" the case in order to obtain relief for the taxpayer. This is true for AMTAP cases in TAS (*i.e.*, AMTAP must agree that the taxpayers are entitled to relief). The most common reason cases closed with no relief was that the taxpayer did not respond to requests for supporting documentation that would have allowed release of the stopped refund, as shown in the table below.

⁵³ See W&I response to TAS information request (July 27, 2011, and updated Nov. 4, 2011).

⁵⁴ TAMIS/Business Objects (BOBJ) Report, FY 2011 Closures. All TAS cases are assigned a Primary Issue Code, and many TAS cases are also assigned a Secondary Issue Code.

TABLE 1.2.1, Issue Code 045 Closures by Relief Code, FY 2011⁵⁵

Cases with Relief	# of Cases Closed	# of Cases Closed
Taxpayer Assistance Orders (TAOs)	72	0.3%
Full Relief	14,917	72.3%
Partial Relief	332	1.6%
Assistance	315	1.5%
OD Function Provided Relief	823	4.0%
Cases with No Relief	# of Cases Closed	# of Cases Closed
No Relief – Law Prevents	15	0.1%
No Relief – Hardship Not Substantiated	16	0.1%
No Relief – No Response	3,620	17.6%
No Relief – TP Withdrew Request	149	0.7%
No Relief – No Internal Revenue Law Issue	15	0.1%
No Relief – Other	349	1.7%
Total Closures	20,623	
Relief Rate		79.8%

These results raise the question of why a group of taxpayers who eventually obtained full relief (*i.e.*, received their full refunds) at such a high rate was pulled into the EFDS filters, which purportedly generate “verified bad” returns 89 percent of the time.⁵⁶

We recognize that the taxpayers coming to TAS may not be representative of the general taxpayer population and we cannot extrapolate the 75 percent relief figure from the TAS study across AMTAP’s entire inventory (which includes cases related to identity theft and other schemes). However, the TAS data clearly demonstrate significant limitations inherent in the IRS verification process and its assumptions. In these cases, the IRS should be asking: what initially triggered the EFDS filters and what steps did TAS have to take to advocate and provide relief for the taxpayers? For example, did TAS case advocates follow up with taxpayers by phone multiple times? If so, would it make sense for AMTAP employees to follow up with a phone call to taxpayers who do not immediately respond to the Letter 4115 requesting documentation of wages or withholding?

EFDS selected approximately one million returns for screening in 2011.⁵⁷ By the IRS’s own estimation, it was unable to “verify bad” 11 percent of these returns, leaving up to 116,000 potentially “good” taxpayers improperly caught up in the EFDS filter.⁵⁸ Of the approximately 20,600 pre-refund cases TAS closed in FY 2011, more than 16,000 (79.8 percent) obtained relief. So by comparing these two numbers, it is reasonable to conclude

⁵⁵ This chart includes PIC 045 cases, plus PIC 425 cases with SIC 045, closed in FY 2011. TAMIS/BOBJ Report, FY 2011 Closures.

⁵⁶ See W&I response to TAS information request (July 27, 2011, and updated Nov. 4, 2011).

⁵⁷ The volume of returns selected to be screened was 1,054,704 in CY 2011 (through Oct. 15, 2011). See W&I response to TAS information request (Nov. 4, 2011).

⁵⁸ Inability to “verify bad” could result from a variety of reasons; it does not necessarily indicate that such a tax return is legitimate or submitted by the person who owns the Social Security number.

that potentially 100,000 innocent taxpayers who did not come to TAS were harmed by the EFDS filter in 2011.⁵⁹ Some probably worked directly with the IRS to obtain relief, and others were probably too intimidated, perplexed, or otherwise unable to respond, with the result that they will not receive their refunds.

The National Taxpayer Advocate raised this concern in her 2005 Annual Report to Congress: "CI's fraud detection methods are not as effective as they should be at screening out non-fraudulent refund claims, and therefore cause undue burden for a significant number of taxpayers."⁶⁰ In its written response, the IRS touted the "efficiency" of EFDS at stopping refunds.⁶¹ We now have evidence that there is significant collateral damage caused by AMTAP pulling in so many legitimate taxpayers. Tens if not hundreds of thousands of taxpayers entitled to refunds are getting caught up in anti-fraud procedures that, at best, require them to devote time and effort to substantiating their claims and, at worst, block them from ever receiving their legitimate refunds.

CONCLUSION

The IRS must deal with the challenging combination of increasing opportunities for refund fraud and decreasing resources to combat such activities. The National Taxpayer Advocate recognizes the need for automated screening mechanisms to alleviate the burden of manual reviews. However, systemic screens are inherently imperfect – they will be both underinclusive and overinclusive. It is therefore critical that the IRS develop a mitigation strategy to ensure it can promptly and accurately resolve the problems of legitimate taxpayers who get caught up in the filters.

It is easy to paint all taxpayers who are ensnared by systemic filters with a broad brush, but experience tells us that even where the IRS believes it has verified that a return is false or fraudulent, it is sometimes wrong. To minimize the harm to innocent taxpayers, the IRS must give taxpayers adequate notice of its findings and an adequate opportunity to respond.

In conclusion, the National Taxpayer Advocate offers these preliminary recommendations:

1. Provide the AMTAP unit sufficient staff and systems resources to work its inventory timely.
2. Make Information Returns Master File data available sooner in the filing season.
3. Adhere to the policy of systemically releasing refunds after 70 days if the IRS cannot determine that the return is part of a known scheme or requires greater scrutiny.

⁵⁹ 116,017 (potentially "good" taxpayers caught up in EFDS) less 11,743 (that obtained relief after coming to TAS) leaves 104,274 "good" taxpayers who were caught up in the EFDS screen in 2011. See W&I response to TAS information request (Nov. 4, 2011). This is a conservative estimate, as we know from our study that some percentage of the taxpayers that receive a hard freeze (purportedly because they are deemed "verified bad") ultimately prevail and receive their refunds. In the TAS study, 84 percent of such taxpayers received relief (81 percent receiving full relief).

⁶⁰ National Taxpayer Advocate 2005 Annual Report to Congress 29.

⁶¹ See *id.* at 46.

- When considering implementation of any front-end verification procedures, concurrently develop procedures to promptly assist taxpayers who demonstrate that they have filed legitimate refund claims.
- When considering alternative treatment streams, conduct a thorough analysis to determine the specific legal basis for the proposed action (or non-action).
- Before “auto-voiding” any tax returns, notify the impacted taxpayers and allow them an opportunity to correct or explain the questionable items.
- Include language in the Automated Questionable Credits notice alerting taxpayers that the tax return is being examined or that they are under audit, and make clearer that there are significant legal consequences for failing to respond to the notice by the deadline.

IRS COMMENTS

The Taxpayer Assurance Program, known as AMTAP, recently completed its second filing season. AMTAP screened and verified almost two million cases in FY 2011, stopping over \$14 billion in false refunds. In FY 2010, AMTAP screened and verified over 800,000 cases, stopping over \$5 billion in false refunds. This 2011 activity represents a 142 percent increase in cases worked and a 162 percent increase in revenue protected over 2010 results.⁶²

The IRS must continually balance the rights of taxpayers with our responsibility to protect the interests of the United States and the majority of taxpayers who accurately file and pay their federal taxes. The voluntary compliance design of America’s tax system requires the IRS to take efforts to support compliant taxpayers by detecting fraud and errors of those looking to be noncompliant. It is a continuous challenge to quickly identify perpetrators and individuals who use sophisticated methods to defraud the nation’s tax system. This detection can be more time-consuming when individuals are not associated with a known scheme, and cases require analysis, third party information, and actions to assure that legitimate taxpayers are protected.

Those looking to defraud the government have become more brazen and are availing themselves to a variety of resources both outside and within the system to try to force the release of false refunds. In some cases, this even includes calling Taxpayer Assistance toll-free telephone numbers or seeking support through the Taxpayer Advocate Service. A current example involves over 200 filings that IRS deemed fraudulent with associated revenue protected of more than \$800,000. Thirty of those false returns had an open TAS case; meaning that perpetrators have contacted the IRS through TAS to try to force the release of the associated refunds. As another example, Operation Mass Mail is a scheme where perpetrators contact toll-free assistors and TAS to force refund release. In dealing with these situations, the IRS follows established taxpayer support requirements which require use of

⁶² AMTAP from the EFDS.

valuable resources to ensure that the fraud determination is correct. These two examples are just a snapshot of the challenges to the IRS in maintaining a balance between revenue protection, providing valid taxpayer support and minimizing taxpayer burden.

As those attempting to commit refund fraud become more sophisticated, the IRS must take steps to respond accordingly. The IRS continues to recognize the importance of taxpayer rights, but we must ensure that processes are in place to effectively stop refund fraud. We have made recent improvements in this regard. The IRS launched two high impact initiatives in May 2011 to identify improvements to better combat fraud, identity theft, and revenue and taxpayer protection. The Accelerated Refund Assurance Program was a servicewide initiative working internally and externally with IRS partners, stakeholders, agencies and departments at the local, state, national and international level to preserve the integrity of America's tax system. The National Taxpayer Advocate participated in this initiative, and provided representatives for our ARAP teams. The IRS is deploying a number of improvements from the ARAP initiative for filing season 2012 and beyond, such as accelerating availability of wage and withholding documents by eight weeks, and launching systemic tools to perform income verification.

An additional effort is the formation of Return Integrity and Correspondence Services, creating a centralized organization for ensuring revenue protection and refund compliance. AMTAP was realigned to this new RICS office October 2011. The new RICS office has quickly moved to balance the taxpayer experience, revenue protection and resource efficiency. During filing season 2011, RICS extended AMTAP seasonal employees to better address inventory needs. For filing season 2012, RICS increased AMTAP staffing significantly, and is training all AMTAP permanent employees on account work to dedicate more higher skilled employees to successfully tackle the complex challenges of refund fraud and identity theft work. To further protect taxpayers and their refunds, the RICS organization is finalizing plans to deploy a specialized identity theft unit in FY 2012.

We respectfully disagree with the National Taxpayer Advocate's conclusions from the TAS study referenced in the report – we believe that it creates an inaccurate perception that all AMTAP cases average a delay of 25 weeks. We believe that the TAS study is not a representative sample of AMTAP cases. We also disagree with the inference that IRS employees have no incentive to work cases that have an extension of a freeze code. IRS employees take seriously their responsibility to accurately assist taxpayers – freezes on accounts do not affect their commitment to taxpayers.

With respect to the specific recommendations in the draft report, the IRS notes the following.

As discussed, the IRS has taken steps to provide the AMTAP unit staff and systems resources to work its inventory timely. We increased our AMTAP staff this filing season and will continue to monitor whether additional resources are necessary (if available). We will also assess the efficiencies gained from the accelerated availability of the Information

Returns data to determine appropriate resources utilization and allocation to best address our inventory.

With respect to the recommendation to make data available sooner in the filing season, in 2009 AMTAP recognized accessing Information Returns Master File (IRP) data earlier in the filing season would allow for faster verification; thus releasing legitimate claims sooner. An ARAP team worked with Modernization and Information Technology Services and IRP to accelerate availability of W-2 data in filing season in order to allow earlier identification of mismatches. We will continue to pursue additional opportunities to shorten that timeframe in filing season 2013.

With respect to the recommendation to release refunds after 70 days, the IRS believes that given the current environment, the IRS must maintain the right to determine when it is inappropriate to release refunds if questions as to legitimacy exist. The IRS developed revenue protection processes over many years using historical data to determine fraud indicia. The IRS refines fraud models each year based on performance and new characteristics and updates procedures for reviewing and processing revenue protection inventory accordingly to ensure indication of fraud before holding a refund. Manual screening processes also ensure that a return meets established fraud characteristics before designation for verification and refund hold. Due to the historical evidence of known fraud, the explosion in fraud and identity theft in the past two years, and the consistent amount of revenue protected by IRS fraud detection efforts developed from this analysis, IRS must maintain the right to determine when a hard refund freeze is appropriate.

Regarding changes to processes, the IRS balances taxpayer rights with the need to stop refund fraud. As we move forward, we will continue to explore opportunities for expeditious treatment and assistance for taxpayers with legitimate refund claims in all stages of design, development, testing and deploying of any new technology, process and procedures. When considering alternative treatment streams, as with our past practices, AMTAP will continue to request specific legal guidance about proposed alternatives.

The IRS will consider the views in the draft report regarding notifying impacted taxpayers before auto-voiding tax returns. The IRS is mindful of taxpayer rights and only uses this policy where we believe appropriate. The IRS developed the policy to “auto-void” returns to address schemes identified based on historical analysis of repeated fraud characteristics. For example, the Operation Mass Mail scheme is a very high volume scheme attempted annually. Part of the scheming effort is to inundate IRS with returns to force release of some of the refunds. In these cases, attempting to correspond on these fraud returns would be an ineffective use of resources and taxpayer dollars. These returns often do not include a valid address. In addition, in some cases, corresponding provides fraudsters with additional or new avenues to try to force refund release.

Finally, with respect to the recommendation to include audit or examination language in the Automated Questionable Credits notice, we have determined that under Revenue Procedure 2005-23 Automated Questionable Credits are not considered audits.

The IRS will continue to work with the National Taxpayer Advocate as we make improvements in detecting and stopping refund fraud while recognizing the rights of legitimate taxpayers.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate recognizes the difficult position the IRS is in as the gatekeeper to the public fisc and applauds its efforts to flag suspicious refund claims. The National Taxpayer Advocate supports the use of front-end screening where appropriate, but firmly believes that an *expedited* mitigation strategy must be part of any such process.

When the IRS selects a return for manual verification or otherwise delays a refund, it should notify the taxpayer and allow him or her the opportunity to respond. Knowing that a significant percentage of legitimate taxpayers will be caught up in the automated filters, it is imperative for the IRS to conclude its verification process or release refunds in a reasonable time. The National Taxpayer Advocate continues to believe 70 days (plus the 14 days used for initial selection) is reasonable, as agreed to in 2006 by CI, SB/SE, W&I, and TAS. This time limitation does not in any way impact the IRS's "right to determine when a hard refund freeze is appropriate." Instead, the time limitation ensures that the IRS makes that determination — whether to issue a hard freeze or release the refund — within a reasonable period of time. This is the least that the IRS can do as a mitigation strategy for legitimate taxpayers who will inevitably be caught up in IRS filters.

The National Taxpayer Advocate understands the difficulty of staffing AMTAP to accommodate the increasing volume of questionable refund claims. Particularly when manual verification is required, it will be challenging for AMTAP to meet the 70-day timeframe without a corresponding increase in personnel. The new RICS organization must closely monitor AMTAP's workload and adjust staffing as necessary to keep up with inventory. Ultimately, Congress will need to make funding decisions that would enable the IRS to adequately staff AMTAP.⁶³

We studied a statistically representative sample of pre-refund wage verification cases TAS closed in FY 2011 in an effort to better understand the reasons for the significant increase in these TAS cases. We found the IRS had placed a hard freeze on the taxpayer's account in at least 50 percent of the cases in this sample, with taxpayers eventually obtaining relief

⁶³ See Most Serious Problem: *The IRS Is Not Adequately Funded to Serve Taxpayers and Collect Taxes*, *supra*.

84 percent of the time.⁶⁴ The average refund amount was over \$5,600 (the median was approximately \$4,100), and the average delay was 25 weeks (with a median delay of slightly under 19 weeks).⁶⁵ While these taxpayers may not be representative of the general taxpayer population, the TAS data clearly demonstrate significant limitations inherent in the IRS verification process and its assumptions. The findings of the TAS study support the need for the IRS to develop an effective mitigation strategy to assist the legitimate taxpayers who will inevitably become caught up in even the best of filters.

The IRS states that some persons who submitted fraudulent returns have come to TAS for assistance, implying a misuse of TAS resources. To support this statement, the IRS refers to a study and 30 cases. We note that the IRS has neither cited a source for this study nor shared with TAS information about those 30 cases, so we do not know the ultimate outcomes. As far as we know, this could be just another instance of the IRS “deeming” fraud but ultimately agreeing that the taxpayer is entitled to relief once it actually looks at the facts of the case.⁶⁶

To eliminate any confusion, the National Taxpayer Advocate would like to point out that TAS does not make substantive decisions in any case. For example, the 84 percent relief rate in the TAS study was a result of advocacy on the part of TAS case advocates, but ultimately it was the IRS that determined the taxpayers were entitled to relief.

In addition, for the 16 percent of taxpayers that did not obtain relief in the TAS study, there is still value in the process. One of TAS’s quality measures is to educate the taxpayer. By informing taxpayers about why they were not entitled to relief, we educate them on tax law and procedure and seek to foster improved compliance in the future.

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See TAS Study. Hard freezes were almost certainly applied in additional cases. In some instances, the IRS may apply a hard freeze by inputting a second TC 570. Because the master file does not capture when a second TC 570 is input, TAS included in its count of hard freezes only cases that contained RCC 3 and TC 841 codes in the 373-case sample.

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See *id.*

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Historically, it is true that a very small number of taxpayers with clearly improper claims approach TAS for assistance each year. When that happens, TAS generally identifies the improper claim or the IRS identifies it when TAS consults with the IRS on the case. Both in absolute and relative terms, however, the number of taxpayers who are brazen enough to attempt to use TAS to further fraudulent activity is infinitesimal. Moreover, the extent of the problem should not be overstated for several reasons. First, it could cause taxpayers with bona fide problems to refrain from seeking TAS assistance out of concern they may be viewed as potential perpetrators of fraud. Second, it could encourage perpetrators of fraud to seek TAS assistance. Third, it could cause case advocates to treat all taxpayers with great skepticism. For the context, the TAS historically has obtained full relief approaching 70 percent of taxpayers who seek our assistance (and partial relief for another three to five percent of taxpayers). In the remaining cases, the taxpayer typically believed he or she was entitled to assistance, and the experience has enabled TAS to educate the taxpayer about the law, which should improve future compliance.

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Provide the AMTAP unit sufficient personnel and systems to work its inventory timely.
2. Continue working to accelerate the availability of Information Returns Master File data to identify mismatches earlier in the filing season.
3. Adhere to the policy of systemically releasing refunds after 70 days if the IRS cannot determine that the return is part of a known scheme or requires greater scrutiny.
4. When considering implementation of any front-end verification procedures, concurrently develop procedures to promptly assist taxpayers who demonstrate they have filed legitimate refund claims.
5. When considering alternative treatment streams, conduct a thorough analysis to determine the specific legal basis for the proposed action (or non-action).
6. Before “auto-voiding” any tax returns, notify the taxpayers and allow them an opportunity to correct or explain the questionable items.
7. Include language in the Automated Questionable Credits notice making clearer to taxpayers the significant legal consequences for failing to respond to the notice by the deadline.